United Nations A/70/275

General Assembly

Distr.: General
4 August 2015

Original: English

Seventieth session
Item 73 (b) of the provisional agenda*
Promotion and protection of human rights: human rights questions, including alternative approaches for improving the effective enjoyment of human rights and fundamental freedoms

Effects of foreign debt and other related financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights

Note by the Secretary-General

The Secretary-General has the honour to transmit to the members of the General Assembly the report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, submitted pursuant to Human Rights Council resolution 25/16.

* A/70/150.

15-12541 (E) 240815

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Report of the Independent Expert on the effects of foreign debt and other related financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights

Summary

The present report provides an overview of the activities undertaken by the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, from August 2014 to July 2015.

During the reporting period the Independent Expert submitted two thematic reports to the Human Rights Council on financial complicity and illicit financial flows and human rights, undertook official visits to Iceland and China and participated in the third International Conference on Financing for Development in Addis Ababa. In addition, he contributed to the study of the Advisory Committee of the Human Rights Council on vulture funds and human rights, as requested by the Human Rights Council in its resolution 27/30.

The Independent Expert also contributed to the ad hoc committee established by the General Assembly in its resolution 69/247, tasked with elaborating a multilateral legal framework for sovereign debt restructuring processes, through a process of intergovernmental negotiations. In this context, the report concludes with reflections by the Independent Expert on the principle of *pacta sunt servanda* (often translated as "agreements (or promises) must be kept") in connection with human rights and the principles of legitimacy and sustainability in the context of sovereign debt obligations, with particular attention to debt restructuring. In his view, an "absolutist" view of the principle of *pacta sunt servanda* does not form part of positive law nor is it part of customary international law. Debt contracts exist in a broader legal and economic universe, in which human rights law, the agency relationship between States and their populations and economic constraints interact with the rights of creditors. This dialogue should take place within the legal framework provided in international law for the solution of normative conflicts.

I. Introduction

1. The present report is submitted to the General Assembly pursuant to Human Rights Council resolution 25/16, in which the Council requested the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights to report regularly to the Council and the Assembly. The report provides an overview of the activities undertaken by the Independent Expert between August 2014 and July 2015, followed by reflections of the Independent Expert on the legitimacy of the principles of *pacta sunt servanda* (translated as "agreements (or promises) must be kept"), legitimacy, sustainability and human rights in the context of international debt obligations.

2. In addition to his core mandate, as outlined in Human Rights Council resolution 25/16, the Independent Expert was requested by the Council, in its resolutions 25/9, 26/7, 27/30, 28/5 and 28/8, to: (a) consider, inter alia, the impact of illicit financial flows on the enjoyment of human rights; (b) contribute to and participate in the third International Conference on Financing for Development and its follow-up process; and (c) provide inputs to the work of the Advisory Committee of the Human Rights Council, which has been requested to undertake a study on the impact of so-called vulture funds on the enjoyment of human rights, a topic that has been followed by the mandate holder for several years.

3. Pursuant to General Assembly resolution 69/247, the Ad Hoc Committee on Sovereign Debt Restructuring Processes has been established for the purpose of negotiating a multilateral legal framework on sovereign debt restructuring processes. The outcomes of the sessions of the Ad Hoc Committee have given new impetus to the discussions being held at the international level relating to the need for timely, orderly, effective and fair debt restructuring procedures. Such debt restructuring procedures should be compatible with existing human rights obligations and standards, as stressed by the Human Rights Council in its resolution 27/30.

II. Activities by the Independent Expert

A. Thematic reports

4. Pursuant to Human Rights Council resolutions 25/9 and 25/16, the Independent Expert submitted two thematic reports to the twenty-eighth session of the Human Rights Council (A/HRC/28/59 and A/HRC/28/60 and Corr.1).

5. The first report, on financial complicity (A/HRC/28/59), focused on the question of lending to States engaged in gross human rights violations. The report was intended to contribute to a better understanding of when financial support may contribute to, or sustain the commission of, large-scale gross human rights violations by sketching a rational choice framework premised on the incentives of authoritarian Governments and private and official lenders. In the report, the Independent Expert reviewed the existing empirical evidence of the relationship between sovereign financing, human rights practices and the consolidation of Governments engaged in gross violations of human rights. He also presented some interim conclusions and invited stakeholders to discuss them. The Independent

Expert will address the legal and policy implications of financial complicity in a future study.

6. The second report of the Independent Expert (A/HRC/28/60 and Corr.1) consisted of an interim study on illicit financial flows, human rights and the post-2015 development agenda. The study highlighted the fact that illicit financial flows generated through crime, corruption, embezzlement and tax evasion represent a major drain on the resources of developing countries, reducing tax revenues and the scope for progressive taxation, hindering development and the rule of law, exacerbating poverty and inequality and undermining the enjoyment of human rights. Tax evasion and abuse are considered to be responsible for the majority of all illicit financial outflows, followed by illicit financial flows relating to criminal activities, such as drug trafficking, human trafficking, the illicit arms trade, terrorism and corruption-based illicit financial flows. According to some estimates[1] developing countries lost $991 billion in illicit financial outflows in 2012, and those flows have increased in real terms at a rate of 9.4 per cent per annum over the period from 2003 to 2012. According to the figures provided, total annual losses were substantially higher than the estimated yearly costs of achieving the Millennium Development Goals.

7. The report outlined how illicit financial flows undermine the enjoyment of economic, social, cultural, civil and political rights and emphasized the need for: (a) due diligence and due process in the fight against illicit financial flows; (b) better protection for witnesses and whistle-blowers; and (c) incorporating human rights considerations in the management of returned stolen assets. The report also contained recommendations on how the goal of curbing illicit financial flows could be operationalized within the United Nations post-2015 development agenda.

8. On 26 March 2015, the Human Rights Council adopted resolution 28/5, in which it welcomed the interim study of the Independent Expert and requested him to convene an experts meeting to inform his final study. That meeting is expected to take place in the fourth quarter of 2015 in New York.

B. Country visits

9. Since taking up his position on 2 June 2014, the Independent Expert has sent requests to make visits to the Governments of China, Egypt, Greece, Iceland, Jamaica, Tunisia and Zambia. He has also requested official visits to various institutions of the European Union to discuss the impact of economic adjustment programmes on Greece and other countries members of the European Union.

10. The Independent Expert is grateful for the official invitations from the Governments of China, Greece and Iceland.[2] He visited Iceland from 8 to 15 December 2014 and visited China from 29 June to 6 July 2015. His visit to Greece is scheduled to take place from 30 November to 7 December 2015. He hopes to be able to visit different institutions of the European Union in early 2016 and to visit countries in other regions, including Africa and Latin America and the Caribbean, in 2016.

[1] See A/HRC/28/60 and Corr.1, para. 10.

[2] As of 24 July 2015.

11. During his visit to Iceland, the Independent Expert paid close attention to how the banking crisis had affected the right to work, social security, housing, health and education and particular social groups. In his report,[3] he concluded that while Iceland had managed the crisis better than many other countries, and had responded overwhelmingly in compliance with its international obligations, there are certain gaps that should be addressed. He recommended that the legal and institutional framework of Iceland be further strengthened in order to prevent a recurrence of a similar crisis and that attention be paid to certain vulnerable groups, such as highly indebted individuals, people living in rented housing, migrants and children living in single-parent households.

12. In the context of his visit to Iceland, the Independent Expert also identified several good practices that States facing a financial crisis can adopt in order to prevent or reduce negative human rights impacts in the context of economic adjustment programmes. He concluded that international organizations and other countries could learn from the particular path chosen by Iceland, which included the protection of its core social welfare system, efforts to ensure citizen participation in the decision-making process and establishing political, administrative and judicial accountability.

13. This visit contributed to one of the six thematic priorities outlined by the Independent Expert in his previous report to the General Assembly,[4] which included identifying good practices regarding how States could avoid negative human rights impacts in the context of debt crises and economic adjustment programmes. While Iceland still faces several challenges in fully overcoming the legacy of the 2008 banking collapse, it is the view of the Independent Expert that other countries could learn from the rich experience of Iceland on how to minimize negative human rights impacts in the context of a financial crisis.

14. From 29 June to 6 July 2015, the Independent Expert conducted his second official visit, to China, in order to assess how its international lending practices contribute to the realization of human rights, in particular economic, social and cultural rights, in borrowing countries. In his end-of-mission statement,[5] the Independent Expert welcomed China's leadership role in the establishment of two new multilateral development banks, the Asian Infrastructure Investment Bank, in Beijing, and the New Development Bank, in Shanghai. He also stressed that a human rights focus would upgrade China's international lending and underlined the need to avoid, mitigate or compensate for negative social, environmental and human rights impacts that may result from international lending and project financing. A comprehensive report on the visit will be presented to the Human Rights Council at its thirty-first session in March 2016.

15. The Independent Expert would like to thank the Governments of China and Iceland for their full cooperation, as well as relevant stakeholders who made themselves available during his visits and the fruitful, open and frank discussions he had in both countries with various interlocutors.

[3] See A/HRC/28/59/Add.1.

[4] A/69/273.

[5] The end-of-mission statement of the Independent Expert on his visit to China is accessible from http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16203&LangID=E.

C. Communications and public statements

16. The Independent Expert exchanged views with Member States in bilateral meetings and through communications on issues brought to his attention. In addition, he issued several public statements on matters which, in his view, required public attention.

17. On 20 August 2014, the Independent Expert and the Special Rapporteur on extreme poverty and human rights sent three communications to the Governments of Argentina and the United States of America and to the main litigating partner, NML Capital Limited, concerning the human rights impact of recent orders issued by United States courts. The letters expressed concern that the rulings may risk pushing Argentina into a debt crisis, with negative implications for the economic, social and cultural rights of its people and that they may also impede necessary debt restructuring in other contexts. The communications argued that such vulture fund litigation, including the court orders secured by NML Capital Limited, may prevent indebted countries from using resources freed up by debt relief for their development and poverty reduction programmes and diminish their capacity to create the conditions necessary for the realization of human rights for their people. The Independent Expert would like to thank Argentina and the United States for the responses received and regrets that NML Capital Ltd. has, to date, not sent any formal reply to his letter.[6]

18. On 27 November 2014, United Nations experts issued a media statement, stressing that if Argentina paid NML Capital Ltd. according to the rulings of the United States courts, the creditor would receive $832 million. In addition Argentina could face demands of up to $140 billion from other holdouts and holders of restructured bonds who could demand repayment on equal terms.[7]

19. The experts voiced their concern about the disruptive impact of such litigation, both in terms of human rights and the sustainability of debt agreements supported by the majority of creditors. In the view of the Independent Expert, the case highlights the need for better rules, allowing predictable and efficient debt restructuring, and the need to address human rights impacts in litigation procedures with vulture funds.

20. The Independent Expert notes that the negotiations between the Government of Greece and lending institutions were emblematic for the absence of clear and human-rights-based rules to address unsustainable debt situations and to ensure timely, orderly, effective and fair debt restructuring procedures. Since the mission to Greece by the previous Independent Expert, Cephas Lumina, in April 2013,[8] the situation, in particular for vulnerable population groups, appears to have worsened, with the total unemployment rate reaching 25 per cent and more than 50 per cent in the case of youth unemployment. There has been a serious deterioration of the social security system, and concerns about access to health services and facilities, as well as medicines, food and housing, are acute. Furthermore, the number of people

[6] See Communications report of Special Procedures, A/HRC/28/85, cases ARG 2/2014, USA 15/2014 and OTH 10/2014.

[7] "Human rights impact must be addressed in vulture fund litigation – UN experts", 27 November 2014, available from http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=15354.

[8] See A/HRC/25/50/Add.1.

at risk of falling into poverty and social exclusion has increased to 35.7 per cent, the highest percentage in the eurozone.[9] In fact, the austerity measures appear to have exacerbated the social crisis in Greece and have failed to stimulate the national economy to the benefit of the Greek population.

21. On 2 June 2015, the Independent Expert urged the Government of Greece and its international lenders to make sure that the burden of adjustment is shared in a fair manner, in compliance with the international human rights obligations of Greece and creditor States under the International Covenant of Social and Economic Rights, the European Social Charter and other international human rights instruments. The Independent Expert welcomed the establishment of a debt audit commission by the Greek Parliament and reminded international organizations and international financial institutions that human rights must be respected when responsibilities are delegated by States to international bodies, such as the European Stability Mechanism and the European Central Bank. In the view of the Independent Expert, it is time to acknowledge that further debt relief will be necessary to prevent Greece from remaining in an economically and politically unhealthy dependence on creditor institutions for decades.[10]

22. On 15 July 2015, the Independent Expert urged the European institutions, the International Monetary Fund and the Greek Government to fully assess the impact of possible new austerity measures to ensure that they do not come at a cost to human rights. He stressed that priority should be given to ensuring that everybody in Greece has access to core minimum levels of economic, social and cultural rights, including the right to health care, food and social security.[11] However, recent developments appear to have gone in the opposite direction, with the monetary authorities imposing restrictions that may endanger the supply of medication, energy and food imports. The Independent Expert is also concerned about the impact of the crisis on refugees and immigrants, whose number has increased as a result of the internal armed conflicts and violations of international humanitarian and human rights law in the Middle East and other regions.

23. The Independent Expert would like to thank the Government of Greece for inviting him to carry out a country visit from 30 November to 7 December 2015 to study the situation in detail.

D. Submission to the Advisory Committee of the Human Rights Council

24. On 3 October 2014, the Human Rights Council adopted resolution 27/30, in which it condemned the activities of vulture funds for the direct negative effect that the debt repayment to those funds, under predatory conditions, has on the capacity of Governments to fulfil their human rights obligations. The Council also requested

[9] Data published by Eurostat on the basis of the 2008-2013 EU-SILC Survey, available from http://epp.eurostat.ec.europa.eu/portal/page/portal/income_social_inclusion_living_conditions/introduction.

[10] See "Greek crisis: Human rights should not stop at doors of international institutions", 2 June 2015, available from http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16032.

[11] See "'Not at the cost of human rights'— UN expert warns against more austerity measures for Greece", 15 July 2015, available from http://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16238.

its Advisory Committee to prepare a research-based report on the activities of vulture funds and their impact on human rights, seeking the views and inputs, inter alia, from the Independent Expert and other stakeholders.

25. In line with that resolution, on 25 February 2015, at the fourteenth session of the Advisory Committee, the Independent Expert presented a paper on vulture funds and human rights,[12] in which he recommended that the Committee: (a) undertake a more comprehensive empirical analysis about litigation by vulture funds and their impact on human rights, covering not only heavily indebted poor countries; (b) carry out a more comprehensive legal analysis from the perspective of international law and human rights law; and (c) elaborate suggestions for States to consider regulative, legislative or other measures within their jurisdictions in order to limit the disruptive effects of vulture fund litigation.

E. Third International Conference on Financing for Development

26. In its resolution 25/9, the Human Rights Council requested the Independent Expert to participate in the third International Conference on Financing for Development, held in Addis Ababa from 13 to 16 July 2015. In this context, on 26 May 2015, the Independent Expert submitted his views on the draft outcome document of the Conference under negotiation by Member States and later participated in two round tables during the Conference, as well as relevant side-events.[13]

27. The Independent Expert stressed the importance of the International Conference for the mobilization of necessary resources to ensure that the future sustainable development goals of the United Nations can be met. Human rights must be at the core of development financing, ensuring the enjoyment of decent life for everyone, free from hunger and with access to education, health care, housing and drinking water. The main message was that international development financing is not just about more resources. In this context, he reiterated the principle enshrined in the United Nations Declaration on the Right to Development, which is that the human being is the central subject of development and should be its active participant and beneficiary.

28. One of the ambitions of the conference was to ensure that international agreements, rules and standards are consistent with each other and with progress towards the soon-to-be adopted sustainable development goals. The Independent Expert welcomed the fact that the outcome document of the Conference, the Addis Ababa Action Agenda,[14] contained an upfront commitment to human rights, but regretted that this commitment did not always find adequate reflection in some of its substantive sections. He appreciated the emphasis that the Addis Ababa Action Agenda gives to combating illicit financial flows and improving the fairness, transparency and efficiency of taxation systems, but regretted that language on

[12] See "Vulture funds and human rights", 25 February 2015, available from http://www.ohchr.org/Documents/Issues/Development/IEDebt/VultureFundsAndHumanRights2014.pdf.

[13] See "Human rights must be at the core of development financing ", comments by Juan Pablo Bohoslavsky on the revised draft outcome document of the third International Conference on Financing for Development", available from http://www.ohchr.org/Documents/Issues/IEDebt/Paper3FFD22May2015.pdf.

[14] A/CONF.227/L.1, annex, endorsed by the General Assembly on 27 July 2015.

tackling the facilitating environment of illicit financial flows in recipient countries, as well as on secrecy jurisdictions and safe havens, remained relatively weak. Furthermore, he had also hoped for a clearer cut, time-bound and measurable commitment to reduce the size of illicit financial flows by 2030.

29. The Independent Expert welcomes the calls incorporated in the Addis Ababa Action Agenda for debt restructurings to be timely, orderly, effective, fair and negotiated in good faith, with the objective of restoring public debt sustainability and preserving access to finance under favourable conditions so that countries can achieve sustainable development. He voiced his disappointment, however, that the chapter on sovereign debt omits any reference to human rights, most notably the guiding principles on foreign debt and human rights.[15]

F. Multilateral legal framework for debt restructuring processes

30. On 5 September 2014, the Independent Expert sent a letter to the Chairman of the Group of 77 and China[16] expressing his views on an initiative by the General Assembly to establish an international legal regulatory framework for sovereign debt restructuring processes. In his letter, he supported the idea that the United Nations system is the correct forum to discuss how to fill the international legal void with regard to sovereign debt restructuring. He also explained the legal need to minimize vulture fund litigation and highlighted relevant international human rights standards in the context of debt restructurings.

31. The Independent Expert also recalled that the issues of foreign debt, debt relief, debt restructuring and excessive demands by so-called "vulture funds" have been covered by his mandate for many years and have been the subject of resolutions of the Human Rights Council, including resolutions 20/10, 23/11 and 27/30.

32. On 26 January 2015, the Independent Expert provided a written submission[17] to the Ad Hoc Committee on Sovereign Debt Restructuring Processes established by the General Assembly in its resolution 69/247. The Committee is tasked with elaborating a multilateral legal framework for sovereign debt restructuring processes through a series of intergovernmental negotiations. In his submission, the Independent Expert discussed the human rights benchmarks States should consider in drafting the multilateral legal framework, and he proposed the following six human rights benchmarks:

(a) The new legal framework should include an explicit reference to debt restructuring and the need to make it compatible with existing human rights obligations and standards;

(b) Risk assessments and debt sustainability analysis carried out prior to a debt restructuring should include provisions to ensure human rights impact assessments;

[15] A/HRC/20/23, annex.

[16] Available from http://www.ohchr.org/Documents/Issues/IEDebt/letter_Chairman_of_the_Group_G77.pdf. See SPB/SHD/GT/ff.

[17] "Towards a multilateral legal framework for debt restructuring: Six human rights benchmarks States should consider", available from http://www.ohchr.org/Documents/Issues/Development/IEDebt/DebtRestructuring.pdf .

(c) The future multilateral framework on debt restructuring should adequately address negative human rights impacts caused by hold-outs;

(d) Debt restructuring should ensure that minimum essential levels for the enjoyment of economic, social and cultural rights can be satisfied even in contexts of financial crisis; and that retrogressive measures affecting the enjoyment of these rights should be avoided;

(e) The human rights principles of impartiality, transparency, participation and accountability should be reflected in a new legal framework for debt restructuring;

(f) International and regional human rights protection mechanisms, national human rights institutions and civil society organizations should be play a role in the decision-making processes with regard to debt restructurings.

III. Reconciling debt obligations with human rights through *pacta sunt servanda*

33. With the aim of contributing to the current debate in the General Assembly on the legal framework for debt restructuring, the Independent Expert presents below some reflections on the scope of a principle of international law — *pacta sunt servanda* — the principle that agreements must be kept — in the context of foreign debt obligations and in the light of international law, including international human rights law.

34. These considerations might be particularly relevant to interpreting the concrete content of two specific principles, legitimacy and sustainability, identified by the Ad Hoc committee on Sovereign Debt Restructuring Processes at its 3rd meeting, held in New York on 27 July 2015.[18]

A. The principle of *pacta sunt servanda* in context

35. The principle of *pacta sunt servanda* is often taken to be a general and absolute rule of law, including of international law. It is understood as one of the legal and theoretical underpinnings that oblige countries to adhere to debt payment schedules no matter the circumstance. *Pacta sunt servanda* may be commonly accepted as a foundation in commercial transactions, leading to a generalized assumption that sovereign debt should be treated as any other private obligations. However, in the view of the Independent Expert, there are several differences.

36. Any presentation of this rule in an absolutist manner (denying the option to discuss possible exceptions to the repayment obligation), without an understanding of the underlying sovereign context, is often an oversimplification and therefore incomplete. In the opinion of the Independent Expert, this discussion is not purely theoretical but has broad financial implications, as the scope and strength of the principle of *pacta sunt servanda* in the realm of sovereign debt can define, to a great extent, who bears the financial losses in debt restructurings.

[18] See A/AC.284/2015/L.1.

37. It is acknowledged that any contract between two or more parties is usually subject to the rules of the broader community. Thus, contracts will not be enforced if they violate the laws and values of the larger group, even if the contracting parties originally agreed to the terms. This is true whether the relevant contracting party is an individual, a corporation or any other entity bound by these broader rules. In the Independent Expert's view, there is no reason to suppose that this same limitation is any less relevant when the contracting party is a sovereign State. Hence, it appears that the *pacta sunt servanda* principle, in the debt restructuring context of this discussion, may have some built-in boundaries set by larger norms, such as international human rights law, as described in the paragraphs below.

38. Sovereignty of the State adds an additional layer of analysis to the conditional element present in any contract. Unlike an individual person who might sign a debt contract, the sovereign State itself is not a "natural" entity that exists in the world — one does not meet a sovereign State walking down the street, for example. Rather, it is an entity ultimately recognized, formalized, even created through a series of laws, traditions and practices, including both international law as well as domestic laws and the traditions of the State itself. As such, the existence and activities of a sovereign State ultimately and necessarily remain intrinsically embedded in this broader legal framework. Or, in other words, any State's debt agreement with creditors implicitly rests upon the legal framework that defines and limits the sovereign State itself.[19]

39. This introduces the question of the appropriate way to understand sovereignty and sovereign obligations with respect to debts. Any legal definition of sovereignty seems to be a characterization of the relationship between a country's Government and its people — between the officials who enter into a debt contract and the population (taxpayers) who ultimately must pay for that contract. Although there are multiple approaches to sovereignty that have developed through different historical periods, contemporary understandings of sovereign statehood often recognize a form of "agency relationship" between government actors (the agent) and the population of the sovereign State (the principal, on whose behalf and in whose interests Government officials must act). This allows for a broad array of governmental forms and does not justify unwarranted interference in internal affairs. Nowadays, it seems clear that a State's population is not merely a resource available for exploitation by the Government. Governments, no matter how they are organized, ultimately have responsibility for and obligations to their population.

40. This agency relationship is already accepted in the context of domestic contracts for corporations and other similar entities. A legal system specifies the conditions under which an action taken by the agent (a company official, for example) can be attributed to and then imposed upon the underlying principal (the company and its shareholders). Only contracts that fall within the scope of the principal-agent relationship, no matter how it is defined by the applicable laws, will

[19] The Independent Expert wishes to thank Professor Odette Lienau, with whom he has consulted for this section of the report (see, in particular, her publication, *Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance* (Harvard University Press, 2014): for a detailed consideration of the ways in which sovereign debt and reputation are intrinsically linked to different conceptions of sovereign statehood, see especially pp. 5-10 and pp. 20-24. Although Professor Lienau refers to illegitimate debt as an example, her arguments can be applicable to sovereign debt more generally).

be enforceable. Sovereign statehood can be characterized as a similar and essential, if generally unremarked upon, agency relationship in the international legal arena.[20]

41. The general principle of *pacta sunt servanda* necessarily includes built-in conditions and limitations; it cannot possibly be absolute, particularly in the sovereign context. The fact that there has been much debate over whether states generally adhere to international law and under which conditions is a testament to the existence of these potential conditions and limitations. The multifaceted nature of sovereign debt makes this debate even more contentious. One set of limitations may arise from the general laws and values that constrain all actors, preventing them from binding themselves or others in unacceptable ways. A second set of conditions may arise from the uniquely sovereign nature of the State itself, and its agency relationship and underlying obligations to its own population. A third constraint may arise from exceptions to the substantive obligation in that the accumulation of interest on debt may have occurred due to conditions outside of the State's control, which could include a widespread global impact, as was the case in the oil shock during the 1970s or could be due to a downturn in terms of trade for a particular State in a competitive global environment. This broader context and set of rules should shape any interpretation of sovereign debt contracts notwithstanding the background principle of *pacta sunt servanda*.

B. The obligations of States and others to their populations is increasingly accepted

42. In the view of the Independent Expert, the idea of sovereign States as entities that are embedded in broader rules and values and as fundamentally responsible for and obligated to their own populations seems widely accepted. It is true that in earlier historical periods, State populations have been viewed simply as subjects to Government rule and, at least implicitly, similar to an available resource for its use and control. However, this view appears to have been gradually rejected by international law and practice, in part through increasing recognition of human rights at the international level.

43. Even in the economic and financial arena, actors have acknowledged the essential relationship between Governments and their populations. For example, the greater focus on cases in which an official subverts his or her duty to the State and population in favour of private gain offers one key area in which this relationship is evident. The attention to corruption results in part from pragmatic concerns about its potential deleterious effect on economic development. But it also connects to a more general and fundamental recognition of the agency relationship at the core of contemporary sovereign statehood. In the 2012 update of its governance and anti-corruption strategy, the World Bank noted that the "contours of a new social contract are emerging. Citizens are seeking a relationship with their government based on transparency, accountability, and participation."[21]

44. This understanding is also articulated in the United Nations Conference on Trade and Development (UNCTAD) Principles on Promoting Responsible Sovereign

[20] See Leinau, Odette, *Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance*, Harvard University Press, 2014.

[21] See World Bank Group, "Strengthening Governance: Tackling Corruption — The World Bank Group's Updated Strategy and Implementation Plan" (Washington, D.C.) 2012.

Lending and Borrowing, adopted in 2012, in which it is noted that, Governments "are agents of the State and, as such, when they contract debt obligations, they have a responsibility to protect the interests of their citizens".[22] Similarly, the Principles state that lenders "should recognize that government officials involved in sovereign lending and borrowing transactions are responsible for protecting public interest (to the State and its citizens for which they are acting as agents)." (see article 1). The United Nations guiding principles on foreign debt and human rights express a similar opinion, that every "Borrower State should conduct a transparent and participatory needs assessment, as part of its annual debt strategy, in order to ascertain whether it has a genuine need to obtain new loans" and that all "lenders should satisfy themselves that a Borrower State has made an informed decision to borrow and that the loan is to be used for a public purpose".[23]

45. Even major private financial actors have, through the lens of risk management, acknowledged the intended social purpose for development finance and the existence of possible limitations in international finance, as seen in part by their adoption of guidelines for socially responsible project finance lending. The June 2013 version of the "Equator Principles", drafted in conjunction with the International Finance Corporation, includes a recognition that participants' "role as financiers" provides an opportunity to engage in socially responsible development, "including fulfilling our responsibility to respect human rights."[24] In short, there has been more a vocal recognition of the obligations that international financial institutions and non-State actors owe to individuals affected by their operations, even when dealing with Governments acting as economic (rather than explicitly political or diplomatic) actors.

C. An absolutist view of *pacta sunt servanda* has not become customary international law

46. Finally, it is also worth highlighting that an absolutist view of *pacta sunt servanda* in the sovereign debt field cannot be understood to be a feature of customary international law. Customary international law would be identified through a combination of State practice and a belief in the existence of a legal obligation (*opinio juris*) to continue payment under all circumstances.[25] To begin with, it is certainly the case that gunboat diplomacy was previously employed by dominant States to enforce sovereign debts on weaker States, which were often reluctant to pay, until the practice of using force to collect controversial debts was outlawed by the Hague Convention Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts (1907). It also true that under the current monetary regime States have defaulted on their sovereign debts when continued repayment becomes untenable. Thus, the State practice of default and non-payment

[22] UNCTAD, Principles on Promoting Responsible Sovereign Lending and Borrowing (January 2012), article 8. See Esposito, Carlos, Li, Yuefen and Bohoslavsky, Juan Pablo (eds.), *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing*, Oxford University Press, 2013.

[23] A/HRC/20/23 and Corr.1, annex, paras. 36 and 38.

[24] The Equator Principles, June 2013 (www.equator-principles.com).

[25] See Bohoslavsky, Juan Pablo, Li, Yuefen and Sudreau, Marie, "Emerging Customary International Law in Sovereign Debt Governance?", *Capital Markets Law Journal*, 2013, vol. 9, No. 1.

(or partial payment) is itself a fairly regular occurrence in sovereign debt,[26] just as in the consumer and business/company debt markets. Furthermore, to the extent that States have paid their debt obligations, seeming to act more in line with absolutist approaches to *pacta sunt servanda*, this behaviour has not necessarily been due to any sense of international legal obligation (or *opinio juris*) that might require such payment. To the extent that a payment obligation has been legally upheld, it has been due to particular domestic court interpretations of the relevant contract.[27]

47. In the fields of economics and political science, it is fairly well established that attention to reputation and creditworthiness in capital markets has been central to sovereign debt repayment.[28] Countries are concerned that, if they fail to make debt payments, they will be unable to access capital at a reasonable cost in the future. This pragmatic reaction to markets, however, should not be confused with an absolute legal obligation to repay. Indeed, it exists entirely independently of any legal insolvency regime that might support and enforce the collective resolution of unpayable debt. This is why, in the domestic context, companies and individuals may avoid or defer the protection of insolvency proceedings if they can consensually resolve debt problems with their creditors. They balance the protection offered by the insolvency regime and the greater growth that can result from a more sustainable financial foundation with the possibility of higher capital costs, at least in the short term.[29] This market element does not preclude the possibility of a legal insolvency regime, nor would it be adversely affected by such a regime. Indeed, the two are separate and entirely complementary.

D. *Pacta sunt servanda* comprehensibly understood in debt restructurings

48. The Independent Expert argues that there is little reason to think that the rule of sovereign debt payment, derived from the more general principle of *pacta sunt servanda*, is absolute. Any contract is necessarily embedded in and conditioned by the broader rules and values of the community. In addition, the uniquely sovereign character of Governments implies an agency relationship with the underlying population that may obligate the Government further. There is no reason to think that past practice has created international law that would stand in the way of a sovereign debt workout regime attentive to these issues. And in practice a number of

[26] See, inter alia, Rogoff, Kenneth and Zettelmeyer, Jeromin, "Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001", IMF Staff Papers, 2002; Reinhart, Carmen M. and Rogoff, Kenneth, *This Time is Different: Eight Centuries of Financial Folly* (Princeton University Press, 2011); Trebesch, Christoph, Michael G. Papaioannou, Michael G, and Das, Udaibir S., "Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts", IMF Working Papers 12/203 (2012).

[27] The globally controversial decisions of courts in the United States of America in the dispute between Argentina and NML Capital, Ltd. are only the most recent of these interpretations. See A/HRC/28/85, cases ARG 2/2014, USA 15/2014 and OTH 10/2014.

[28] See Tomz, Michael, *Reputation and International Cooperation: Sovereign Debt Across Three Centuries* (Princeton University Press, 2007) (general importance of reputation); and Odette Lienau, *Rethinking Sovereign Debt* (interaction of reputational effects with ideas of sovereignty and creditor structures).

[29] See Lienau, Odette, "The Longer-Term Consequences of Sovereign Debt Restructuring," in *Sovereign Debt Management*, Buchheit, Lee and Lastra, Rosa (eds.) (Oxford University Press, 2014).

exceptions to the repayment obligation arise as a pure consequence of economic conditions outside the sovereign debtor's control. So how are all these considerations relevant in the context of debt restructurings?

49. A serious limitation to the principle of *pacta sunt servanda* is the set of sovereign obligations in the contemporary global order. If a State and its population must always repay debt under any circumstance, no matter the purpose for which the funds were borrowed,[30] how they were spent[31] or the amount of effort put into reimbursing them,[32] this idea clearly relies on an overly simplistic notion of sovereignty and contract. However, as explained earlier, the economic fate of a given population and its obvious implications in terms of human rights constitute a core element of modern notions of sovereignty.

50. Under certain circumstances, particularly when economic, social and cultural rights at risk, the operation of contract may not be sufficiently compelling to ask the populations of Sovereign States to fully replay their debts in a timely manner. Political institutions shape sovereign borrowing, and lending to sovereign States also shapes their political institutions. That means that, transitively, the capacity of States to respect, protect and fulfil human rights is determined, to some extent, by financial transactions.[33] This is the case when the sovereign debt is contracted or (at later stage) renegotiated.[34] The scope of the *pacta sunt servanda* principle is thus limited by sovereignty and human rights.

51. In light of the *erga omnes* effects of human rights, none of this should appear to be unusual to lenders: they should look at the consequences of their loans and claims in terms of affecting the capacity of the State to meet basic human-rights requirements. Domestic creditors facing individual consumer debtors may be similarly limited by laws that exempt certain essential property from collection efforts. Valid debt contracts and their renegotiation should be undertaken in light of the bounds of legitimate sovereign activity. Since human rights play an important role in defining a core element of modern notions of sovereignty, sovereign debt (and related claims) that may translate into serious damage for the borrower's population potentially violates human rights law.[33] The outcome of sovereign debt and debt restructurings should take the legal needs and rights of the underlying population into consideration.

52. There is a growing set of international standards suggesting that lenders should consider the consequences of their financial decisions in order to not affect the obligation of States to progressively achieve economic, social and cultural rights, using their maximum available resources (International Covenant on Economic, Social and Cultural Rights, article 2.1). The Guiding Principles on foreign debt and human rights, the Guiding Principles on Business and Human

[30] See Leader, Sheldon and Ong, David, eds., *Global Project Finance, Human Rights and, Sustainable Development*, Cambridge University Press, 2011.

[31] See A/HRC/28/59.

[32] See Reinisch, August, and Binder, Christina, "Debts and State of Necessity", in Bohoslavsky and Letnar, op. cit., pp. 115-128.

[33] See Bohoslavsky, J. P. and Letnar, J., eds., *Making Sovereign Financing and Human Rights Work*, Hart Publishing, Oxford, 2014.

[34] This is something that is becoming clearer and clearer when debt repayment poses a peace challenge to the international community. See Goldmann, M., "Sovereign Debt Crises as Threats to the Peace: Restructuring Under Chapter VII of the UN Charter?", *Goettingen Journal of International Law*, 2012, vol. 4.

Rights (see Human Rights Council resolution 17/4) and the UNCTAD Principles on Responsible Sovereign Lending and Borrowing mentioned above, give much consideration to the due diligence duties of lenders, highlighting the fact that a realistic assessment of a sovereign borrower's capacity to service a loan must be made. It is clear that unsustainable debts negatively affect the achievement of development goals and the realization of economic, social and cultural rights.

53. The increasing recognition of debt sustainability as a principle of public international law, which aims to promote economic development, growth and human rights, reveals and synthesizes a gradual change towards a debt paradigm more respectful of the importance of human rights.[35] This paradigm change, which became clear after the end of the Cold War, recognizes the public interest in debt practices aiming to promote such public goods.

54. As stated in a recent UNCTAD report on sovereign debt: "[d]ebt sustainability is not just a financial category. Rather, full debt sustainability is only achieved when debt service does not entail intolerable sacrifices for the well-being of society."[36] On the other hand, as highlighted by the Guiding Principles on Foreign Debt and Human Rights, "[d]ebt sustainability assessments must not be limited to economic considerations (the debtor State's economic growth prospects and ability to service their debt obligations) but must also take into consideration the impact of debt burdens on a country's ability to achieve the Millennium Development Goals and to create the conditions for the realization of all human rights."[37]

55. To think of sovereign debt markets as totally independent from the notion and realization of social and economic human rights is something unacceptable not only from an economic point of view,[38] but also from a legal perspective. Once it is acknowledged that there are links between sovereign debt and the realization of economic, social and cultural rights, there may be a clash of international norms, or even regimes, focusing on different public goods.

56. When there is a relationship of conflict between two valid and applicable norms that lead to incompatible decisions, the effort should be made to interpret them so as to give rise to a single set of compatible obligations. In this regard, it is worthwhile to recall the conclusion of the Study Group of the International Law Commission that, in the case of conflict between one of the hierarchically superior norms (including human rights *erga omnes* obligations) and another norm of international law, the latter should, to the extent possible, be interpreted in a manner consistent with the former.[39] This is why *pacta sunt servanda* needs to be reconciled with human rights law in the context of debt restructurings.

57. Both sovereign borrowers and lenders of every type are asked to protect human rights. More specifically, in its general comment No. 3,[40] the Committee on

[35] Bohoslavsky, J. P. and Goldmann, M., "Sovereign Debt Sustainability as a Principle of Public International Law: An Incremental Approach", UNCTAD Working Paper, March 2015, Geneva. See also Riegner, Michael, "Sustainability as a General Principle in Sovereign Debt Restructuring," 2015.

[36] UNCTAD, "Sovereign Debt Workouts: Going Forward: Roadmap and Guide" (2015), Geneva.

[37] Human Rights Council resolution 20/10.

[38] See Dowell-Jones, M. and Kinley, D., "Minding the Gap: Global Finance and Human Rights" *Ethics & International Affairs*, Issue 25.2.2011.

[39] See A/CN.4/L.702, para. 14 (42).

[40] E/1991/23, annex III, para. 10.

Economic, Social and Cultural Rights developed the concept of minimum essential levels of each economic and social right, which every individual should enjoy. These minimum core obligations suggest, in a universal fashion, some fundamental implications for sovereign debt generally, and more specifically for debt restructurings.

58. These human rights law commitments serve to remind all parties that the general principle of *pacta sunt servanda* applies to all international obligations, including human rights obligations, not just debt contracts. This inherent respect for all agreements often gets lost in the debates that emphasize the principle of *pacta sunt servanda* solely for financial creditors. Since the principle may also work as an argument in favour of human rights in sovereign debt, a comprehensive interpretation of its contents and implications is of paramount importance.

59. Therefore, as States need to be able to comply with *pacta sunt servanda* with regard to both debt and human rights obligations, all relevant rules of international law applicable in relations between the parties should be taken into account when interpreting international norms, as indicated by the Vienna Convention on the Law of Treaties (article 31.3.(c)).

60. These reflections do not ignore the fact that expectations of repayment still dominate, as demonstrated, for example, in the current debate on the debt crisis in Greece. Yet, more and more attention is being paid to how sovereign debt is linked to human rights. This is particularly true in the context of debt crises, where both official and civil society initiatives at the national and international level try to minimize the human suffering associated with these painful experiences. The debate about how sovereignty, human rights and *pacta sunt servanda* interact with each other might offer fruitful insights for the negotiations of a new legal framework being carried out by the Ad Hoc Committee on Sovereign Debt Restructuring Processes established by the General Assembly, complementing the six human rights benchmarks submitted by the Independent Expert on 26 January 2015.[41]

IV. Conclusions

61. **The Independent Expert is of the opinion that a more nuanced view of the *pacta sunt servanda* principle could be essential to the consideration of the links between debt and human rights. In his view, an absolutist version of this principle (i.e. denying the option to discuss possible exceptions to the repayment obligation) should not be considered as part of either positive law or of customary international law, and it deserves further discussion and detailed attention. Debt contracts exist in a broader legal and economic universe, in which the relationship between States, including in the financial sphere, and their populations is marked by international human rights law. Lenders may prefer not to acknowledge it, but they are not unaware of this link, hence their increasing due diligence duties to prevent violations of economic, social and cultural rights.**

62. **The increasing importance attached to sustainability as a principle in the law of sovereign debt is consistent with a modern notion of *pacta sunt servanda***

[41] See "Towards a multilateral legal framework for debt restructuring: Six human rights benchmarks States should consider" (http://www.ohchr.org/Documents/Issues/Development/IEDebt/DebtRestructuring.pdf)

grounded on contemporary understandings of sovereignty, legitimacy and human rights. Sustainable debt portfolios and debt restructuring agreements should include growth and repayment capacity, but should also take into account their impact on the implementation of economic, social and cultural rights of the sovereign debtor's population. An examination of this fundamental claim should, in turn, shed some light on the principles of legitimacy and *pacta sunt servanda* in the debt field.

63. **A comprehensive understanding of the *pacta sunt servanda* principle would not introduce legal uncertainty. Not only because there are well-established rules for interpreting conflicting international norms in the Vienna Convention on the Law of Treaties, including a helpful guide elaborated by the International Law Commission,[42] but also, above all, because denying or not facing the existence of a normative conflict is, in fact, what provokes deep uncertainty. If financial obligations and human rights are considered to be mutually exclusive obligations, without the possibility of dialogue between them, one prevailing over the other depending on political and economic factors, without attaching any importance to what a systematically integrated international law has to say in this regard, there will be continuing uncertainty.**

64. **This is also a crucial reason, in the view of the Independent Expert, for establishing a multilateral legal framework on sovereign debt restructuring processes that would authoritatively identify and interpret the rules. This framework would also contribute to reducing legal uncertainties in this field.**

65. **In the present report, the Independent Expert aims to contribute to the ongoing discussions by providing nuanced views on how the principles of legitimacy, sustainability (both recently identified by the Ad Hoc Committee on Sovereign Debt Restructuring Processes) and human rights law can influence the contemporary understanding of the principle of *pacta sunt servanda* in the context of debt crises.**

[42] See A/CN.4/L.702.